CAPITAL, INEQUALITY AND PUBLIC POLICY

Graham Room, University of Bath

Review Article: Thomas Piketty, *Capital in the Twenty-First Century*, Belknap/Harvard University Press, 2014, 696 pp, ISBN 978 0 674 43000 6

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1. Introduction

Thomas Piketty (2014) has produced a study attracting world-wide attention: by economists, but perhaps even more, by the policy elites, the media and the educated public. His translator Arthur Goldhammer has done a terrific job and the resulting text, while extending to almost 600 pages (even excluding the notes) is lucid and immensely readable. There is careful reference to the important empirical data on which the study is based but this does not weigh the book down, and those data that are marshalled in the book itself – as distinct from being made available on-line for the technically-minded reader – are helpful and clearly presented. The opening and concluding chapters provide admirable summaries of the main argument, for the reader who cannot afford the time to plough through the whole text.

Piketty's book warns us that capitalism has an in-built tendency to growing inequality. We cannot rely on wealth and prosperity 'trickling down'. Nor can we take comfort from the 'Kuznets curve', predicting that while inequality is likely to be high in the early stages of development, it will then progressively fall. It is true that inequalities of capital ownership and income from capital fell in the period 1914-45; but this was due to the destruction of wealth in two world wars, and the social and political turmoil of the time. Now however old trends in inequality have re-asserted themselves. What is needed is purposeful government action to reduce such inequalities: without these, the future of our societies is likely to nasty and brutish.

These conclusions have been political dynamite: they have been widely acclaimed by the left and resisted by the right. They deserve attention by the European social policy research community for at least three reasons. First, welfare systems developed in western industrial societies in part as a response to the inequality and insecurity that capitalism engendered for the mass of the population. Picketty tells us that those inequalities, muted somewhat during the mid-20th century, are likely to get worse through the present century. Second, Piketty argues that institutions and public policies matter: he may not say a lot about these, but he issues an implicit invitation to the social policy research community, to flesh out and test what he argues. Third, in his final section, Picketty examines the social and economic crisis of the Eurozone and sets out a number of reforms: these should be of interest to all scholars of European policy.

Nevertheless, the thesis that Piketty develops needs to be treated with some care; and it cannot be accepted without significant modification.

2. Capital and Inequality over three centuries

Piketty tells us that economic analysis should be embedded in an appreciation of the historical and institutional context. Quite right. This already marks him out from much of orthodox economics, with its mathematical formalism. Piketty's own study ranges across three centuries, even if this is constrained by the sources of data that are available to him:

France and the UK offer him the most in this regard, from the late 18th Century to the present.

He underlines this historical dimension by peppering his story with Jane Austen and Balzac, and their characters' efforts to cope with the contours of inequality of their time. For the impoverished but ambitious bachelor or spinster, the path to security lay through marriage, whether into landed wealth, or the new industrial property of the bourgeois *nouveaux riches*. Nevertheless, Piketty is then at risk of viewing capital and inequality over the succeeding centuries overly through the lens of that period.

This was a world of agricultural rents, supplemented by legacies vested in safe government bonds. This was the world delineated by David Ricardo (1821): with rents securing a rising share of national output, while entrepreneurs struggled to win a fair profit and the labouring populace was left to survive on the breadline. This is the portrait of industrial society that Piketty – perhaps unwittingly - generalises across the centuries: and while the first half of the 20th century may have seen a shift to a more meritocratic and egalitarian order, recent decades, he argues, have seen that older and less palatable dynamic re-assert itself.

It is this dynamic that Piketty aims to capture in the central argument of the book:

> '*When the rate of return on capital [**r**] exceeds the rate of growth [**g**] of output and income, capitalism generates unsustainable inequalities that undermine the meritocratic values on which democratic societies are based' (page 1).*

How are we to judge this statement? It is not enough to display the trends in **r** and **g** in different countries and the inequalities which may then arise. What we also need is a theory of how the economy works – and how these different variables thus affect each other. This Piketty fails to provide. Or, insofar as he does provide such a theory, it is one which is still stuck in the agrarian society of Austen and Balzac and Ricardo, with the *rentiers* enjoying a stranglehold on the distribution of income. Marx – and indeed Adam Smith before him – looked beyond that agrarian society to the new modes of capitalist production that were emerging, the new social and property relations they entailed. Many of their successors did the same - Veblen and Schumpeter, Keynes and Hayek – albeit with a diversity of approaches. This is what we need today, if we are to understand how capital and inequality are evolving in our own century.

Consider the dynamic of **r** and **g,** as presented by Piketty.

In the long-term, the rate of growth of national output and income **g** depends on the rate of technical progress and the growth of the population. Piketty reckons that rates of technical progress are unlikely to exceed 1%; and with falling birth rates world-wide, the annual rate of growth of output is unlikely to exceed 2%. Meanwhile, the long-term rate of return on capital **r** was around 5% during the 19th Century; war and social change in the early-mid 20th Century disrupted this stability; now however, with inequalities in capital ownership returning to former levels, we can he claims expect that rate of return to be restored. With **r** therefore generally above **g**, inequalities can only grow.

Piketty adds a further equation in justification of his argument: $\boldsymbol{\beta} = \mathbf{s/g}$.

Here **β** is the capital/income ratio, **s** is the savings rate and **g** is again the growth rate.

This equation describes the value to which **β** tends in the long-term, for given values of **s** and **g**. Piketty has already told us why he expects **g** to fall during the coming decades; this implies that with a fairly stable saving rate **s**, the capital/income ratio **β** will steadily increase. However, both **s** and **g** 'depend on millions of individual decisions…and are largely independent of each other' (p 199).

What this misses however is the dynamic interrelationship of **r, s** and **g.** The *rentier*'s return on capital in the 19th Century may have enjoyed long-term stability at around 5%; and this may, as Ricardo argued, have been dictated at the beginning of that century by the rate of return on land and natural resources. Now however what is needed is an understanding of how that rate of return is determined in industrial and post-industrial societies. Marx, Schumpeter and Hayek centred their attention on entrepreneurs, their capacity to innovate and invest and their readiness to take risks. Keynes and his successors underlined the uncertainty that such entrepreneurs nevertheless faced and the important role of government, in providing a stable framework of expectations, not least through programmes of public expenditure and investment. It is these rates of public and private investment that then drive the rate of technical progress and the rate of growth **g.** Sluggish growth will soon lead to a declining rate of return **r**. And for the Keynesians at least, the rate of savings **s** will also then fall.

It is therefore quite insufficient for Piketty to offer his equations, without any more thorough and dynamic analysis of the economy to which they refer. In the absence of that analysis, his grounds for asserting that **r** is likely to exceed **g** are tenuous; the same goes for his assertion that **β** will steadily increase. And yet it is on these assertions that the rest of his argument about growing inequality rests.

3. The Rise of the Super-rich and the Super-managers

Piketty points to three major changes in our industrial societies, since the start of the 20th Century, in the contours of inequality.

First, the middle classes have acquired a significant share of national wealth, notably through ownership of their own housing. This represents a significant shift from the world of both Ricardo and Marx, with the mass of the population lacking any wealth and haunted by the spectre of Malthusian starvation. Second, the expansion of education and the rise of high-skill occupations are associated with recent waves of 'skill-biased technological change'. Third, the last thirty years has seen an enormous increase in rewards for the 'super-managers', especially in the US and the UK and especially in the financial sector.

For Piketty, it is the last of these that is most significant for our understanding of capital and inequality in the 21st Century. This is consistent with a wide range of other recent scholarship on the 'winner-take-all society' (Frank and Cook, 1995). Piketty refers to this as 'meritocratic extremism' – the 'apparent need of modern societies to designate certain individuals as "winners"' (p 334). But how are we to understand and evaluate this development?

Here again, Piketty's thinking is perhaps too deeply rooted in the context of early industrial capitalism. Thus he seems generally content with the traditional distinction between income from capital and income from labour. As we have seen, income from capital he sees first and foremost as the income of the *rentier.* It is therefore no surprise that he treats the incomes of the super-managers as income from work. Nevertheless, those incomes have increasingly taken the form of capital gains and equities. They may not be incomes *from* capital; but they are incomes *in the form of* capital. And once received, they are a source of income *from* capital for the recipients and their families.

For Piketty however, capital is either inherited or the carefully accumulated result of saved wages, a nest-egg set aside for retirement. He points us again to the experiences depicted by Jane Austen and Balzac, as having a timeless relevance. Of course, we might accept that 'saved wages' can embrace the capital gains and stock options of the super-managers, no less than the far more modest sums that the wage- or salary-earner puts aside each month. But again, this surely calls out for an understanding of the new modes of capitalist production that have emerged in recent times and the new social and property relations they entail.

Piketty makes only the briefest of references to 'entrepreneurial income' and 'entrepreneurial labour' (pp 41, 204, 439); and he provides no analysis of its place within the modern economy and its relationship to innovation and risk-taking. Nor therefore does he examine how far the stupendous rewards paid in the financial sector might be said to represent compensation for innovation and risk taking. He does not engage with Galbraith's argument that much of this involves predatory looting of corporate and public wealth (Galbraith, 2009): behaviour that has less affinity with entrepreneurship than with Russian oligarchs and international criminals.

Nor does Piketty consider the potential relevance of Veblen's account of the 'leisure class' (Veblen, 1899). This is the super-rich as a status group. As Weber pointed out, such status groups cement their solidarity by inter-marriage and by shared patterns of consumption (Gerth and Mills, 1948: Ch 7). The latter reinforce their closure and their social and economic distance from the larger society.

It is common for such status groups to admit and embrace the most capable and loyal of the upwardly mobile; and to bestow on them the appropriate wealth and style of life, not as a reward for effort, but to secure their moral commitment and loyalty. To use the distinction first made by Turner (1960), this is not so much 'contest mobility' as 'sponsored' mobility. It is then unsurprising that, as Piketty notes, the super-rich include several different social groups, some with very high incomes from inherited capital, others with high incomes from 'labour' (p 301): all united in self-congratulation and defence of their shared accomplishments. After all, does not the wealth and privilege showered upon the super-managers, as marks of their success, demonstrate the efficiency with which the recruitment and promotion mechanisms of large corporations operate?

Piketty is rightly dubious of attempts to justify these high rewards. Can the super-incomes of the super-managers be explained in terms of skill-biased technological change? Piketty doubts that we can identify and distinguish the marginal productivity and skill of the top 1% (p 330ff). Compensation committees flinch at making such assessments and seem simply to pay the 'going rate'. But what basis is there for confidence that these recruits are indeed the most capable of the upwardly mobile? Gladwell (2008) has cogently argued that contingency – luck – is as important as talent: and that had chance produced a quite different set of candidates, a no less plausible celebration of their scarce talent would have emerged from the bosom of their new social home. To this extent, Piketty's 'meritocratic extremism' reflects not so much the extraordinary talent of the beneficiaries, as the closure and solidarity of the various economic and political elites.

4. The Role of Interests and Institutions

The half-century after 1914 produced more egalitarian societies. Two world wars devastated the publicly and privately held wealth of many of the combatants; wars and depression produced mass pressures for a more socially active government. Welfare systems and highly progressive income taxation were the result. As Piketty argues, politics and institutions matter.

From the 1980s however, that legacy came under attack from neo-liberal doctrines and policies, including the privatisation of public assets. Piketty's account of this attack is rather limited: for a more thorough treatment we must look to other writers, such as Hacker and Pierson (2010). Their analysis of winner-take-all politics acknowledges their debt to Piketty's earlier work: the trade in ideas could usefully flow the other way also.

Hacker and Pierson point out, for example, how the super-rich in the US have benefitted over recent decades from the capital gains associated with neo-liberal deregulation and tax cuts. Such windfalls have then been channelled in part to finance the major political parties. The political influence thereby secured has enabled the super-rich, not necessarily to reverse social legislation, as to block its application to the changing conditions of today's world, so that it just 'drifts', becoming increasingly ineffectual (Ch 9).

The social legislation of mid-century responded to the voices of the masses, protecting them against the insecurities of industrial society and pooling the risks that they faced (Baldwin, 1990). In recent decades, it is from the rich and the major corporations that the most strident calls for protection have come, with government and the taxpayer underwriting the stability of the financial institutions in particular. With government-mandated pensions and government bonds increasingly mediated by those institutions, they simply cannot be allowed to fail. That gives them enormous leverage, politically as well as economically. Inequality of power goes with inequality of income and of capital.

But to what end? Why do people want to be so rich: and having become rich, why do they want to be even richer? This is not a question that Piketty poses: but Hacker and Pierson provide a clue. The efforts of the super-rich are devoted to 'shifting the risks of their new economic playground downward' (p 13). Amidst the *anomie* and uncertainty of capitalist societies, the prize is to maintain freedom of manoeuvre, block unfavourable developments and offload uncertainty onto others (Marris, 1996; Pierson, 2004). This is a struggle to design the future: to ensure that come what may, tomorrow will turn out well. This is why, as Keynes observes, the accumulation of wealth is often not so much for eventual consumption, it is for some indefinitely distant date, to ensure a place in the sun, whatever the future disposition of the world (Tily, 2007: 142). Not least, it assures the super-rich that even amidst the devastation likely to be unleashed by climate change, their security and continued well-being will be assured.

5. National and Global

In Chapter 12 of his book, Piketty concedes that his focus up to that point has been too narrowly national. Now he aims to set his analysis in a global context. This includes a consideration of the global distribution of billionaires and the potential role of the sovereign wealth funds of China and other emerging economies.

There is little if any attempt to return to his basic equations and examine how they play out beyond a strictly national context – in terms for example of capital accumulation, growth and savings in a transnational context. Nor – to set alongside his treatment of billionaires and sovereign wealth funds - is there much on the role of multinational corporations.

International economic relations are treated primarily in terms of capital flows and economic growth rates. There is little on the relationships of dependence that this can involve and the adverse terms on which countries may find themselves incorporated as the vassal states of the major economic powers (Weiss et al., 2004; Arrighi, 2007). Nor does Piketty say much on the effects of economic globalisation on employment in the industrial societies of the north, with the weakening of trade unionism and the erosion of social benefits.

Piketty refers to the new rich of the BRICS countries and the other newly emerging economies. He points to how these are selectively recruited into the ranks of the super-rich (p 464-5) – the very status group sponsorship and closure to which we referred above. He underlines how this community can dissociate itself from any national community, its ties and obligations, by its use of offshore tax havens. The wealth thus secreted amounts to perhaps 20% of global GDP (pp 465-7).

Finally, Piketty argues (pp 436-9) that these developments are likely to produce widespread political discontent, unless there is a corresponding increase in repression. Nevertheless, given the scope for fragmenting and demonising malcontents, repression may well be more viable and effective than Piketty seems to expect.

6. Policy Implications and Recommendations

Piketty ends by addressing the implications for public policy, both nationally and internationally.

He makes brief reference to capital controls, protectionism and industrial policy, but rather dismissively: here are few echoes of such scholars as Wade (1990, 2004). He has hopes for the redistribution of rents from oil production, but he does not consider whether this approach might be extended to other natural resource endowments. He is intrigued by the limitations on the individual property rights enjoyed by Chinese billionaires: but he does not consider more generally how individual and collective property rights might be re-worked for the capitalism of the 21st Century, with limitations on the freedom of individuals to appropriate the fruits of collective effort (Macpherson, 1962; Hirsch, 1977). Instead, his main focus is on a global tax on capital: this he expects both to limit the growth of inequality and to enable better regulation of the financial and banking system. The details of how this would operate are however left rather sketchy, as is its political feasibility.

From here, Piketty turns finally to the crisis of the Eurozone. His attention is on the institutional reforms that Europe requires: in Piketty's view, a new and more democratically accountable authority for fiscal and budgetary management. This, he reckons, would enable Europe to free itself from the shackles of the Maastricht budgetary rules, and permit a more vigorous and effective economic policy for growth and investment. Such growth would in turn, his equations suggest, serve to moderate inequality.

Such institutional reforms may be necessary, but they are unlikely to be sufficient, without an appropriate economic strategy. Again however, Piketty suffers from the lack of a clear theoretical analysis of how a modern economy works. His position would, in particular, be considerably strengthened by a Keynesian account.

It is important to be clear as to what the Keynesian message was - and what it was not. Keynes called for active government to address the challenges of both economic depression and expansion. He sought less to abolish capitalism, more to save it from itself. Market economies could not be expected to look after themselves.

In his *General Theory* (1936), Keynes faced an economy with high unemployment, but no confidence among businesses that it made sense to invest – and no confidence among banks that it made sense to lend. Government had to take the initiative and engage in programmes of public investment. These would not only generate activity and incomes in the here and now, but would also give businesses confidence themselves to invest, confident that those investments would yield returns by the time they came on stream, because of the improved economic situation. They would also build economic capacity for the future, in terms of industrial plant, skills and public infrastructure.

Monetary policies will not do the trick: central banks can therefore play only a limited role. Nor indeed are supply side measures sufficient. What is needed instead are major programmes of public investment that will generate economic growth and build up Europe's future economic capacity. This is what can also make public sector deficits manageable. This is the central message of Keynesian economics, but one which the Eurozone is failing to heed.

At the end of 2011, the European Union took fresh steps (albeit without the UK) towards a fiscal union, in an effort to satisfy the markets and bring back stability for the Euro. New rules of fiscal prudence were put in place: national finances would henceforth be in a German straitjacket. The German approach, as consolidated over the post-war period, was one of classical fiscal prudence, little influenced by Keynes. Year after year, an export surplus in manufactures meant that a gently deflationary fiscal stance at home was not inappropriate. Now the German model is being imposed on countries whose situation is very different. It remains to be seen how far the German model, set in a Europe-wide context, will allow for proactive public investment programmes of the sort that Keynes envisaged. Without this, the EU is likely to face general deflation and zero or low growth for the rest of this decade.

Today's concern with appeasing the markets would have seemed strange to Keynes, with his memory of how badly the markets had served the western economies, during the depression of the 1930s and the mobilisation of resources for total war. He called instead for the 'euthanasia of the *rentier*': the side-lining of finance capital and its subordination to the public investment programmes of the active state. The ascendancy of the financial markets which developed from the 1980s will need to be put into reverse, if Piketty's institutional reforms are to have much hope of success.

This is more easily said than done. Powerful financial interests underpin the present regime. Fiscal reform and tightening will still be required in many countries. Fiscal reform can however mean many things. It may mean cutting back on public services and support for the poor. But it can also mean cutting back on fiscal welfare for the rich and the closing of tax havens. Politics will be back.

Notwithstanding therefore the limitations of his study, Piketty has set the debate moving again. Henceforth it will be much more difficult for the opponents of reform to celebrate inequality, as the price we should all be ready to pay for growth, prosperity and international harmony. Not least, Piketty has set the scene for a debate which must involve not only economists but also students of social policy, especially those concerned with the future evolution of the European Union in particular.

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